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No. 79-980

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1979

MORTON-NORWICH PRODUCTS, INC.,

Petitioner,

vs.

THE UNITED STATES,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

Petitioner Morton-Norwich Products, Inc. (hereinafter referred to as "Morton-Norwich") prays that a writ of certiorari issue to review the judgment of the United States Court of Claims entered in the above-entitled case on July 18, 1979, which judgment became final upon denial of the petition for rehearing on September 28, 1979.

OPINIONS BELOW

The opinion of the United States Court of Claims is set forth in Appendix A and is reported at 602 F.2d 270. The Court of Claims denial of Morton-Norwich's petition for rehearing *en banc* is set forth in Appendix B.

JURISDICTION

The opinion of the United States Court of Claims was filed on July 18, 1979. Appendix A. A petition for rehearing *en banc* was filed with the United States Court of Claims and was denied on September 28, 1979. Appendix B. This petition for writ of certiorari invokes the Court's jurisdiction under 28 U.S.C. § 1255(1).

QUESTION PRESENTED

Whether interest on a deficiency in federal income tax which has resulted from an exercise of discretion by the Government under Section 482 of the Internal Revenue Code of 1954, as amended, should commence on the relevant income tax return due date or, as contended by Morton-Norwich, on the date of notice and demand for payment of the tax.

STATUTORY PROVISIONS INVOLVED

I.R.C. Sec. 531. IMPOSITION OF ACCUMULATED EARNINGS TAX.

In addition to other taxes imposed by this chapter, there is hereby imposed for each taxable year on the accumulated taxable income (as defined in section 535) of every corporation described in section 532, an accumulated earnings tax equal to the sum of—

(1) 27½ percent of the accumulated taxable income not in excess of $100,000, plus

(2) 38½ percent of the accumulated taxable income in excess of $100,000.

I.R.C. Sec. 482 (as amended). ALLOCATION OF INCOME AND DEDUCTIONS AMONG TAXPAYERS.

In any case of two or more organizations, trades or businesses (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) owned or controlled directly or indirectly by the same interests, the Secretary or his delegate may distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among such organizations, trades, or businesses, if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such organizations, trades, or businesses.

I.R.C. Sec. 6151 (as amended). TIME AND PLACE FOR PAYING TAX SHOWN ON RETURNS.

(a) *General Rule.*—Except as otherwise provided in this section, when a return of tax is required under this title or regulations, the person required to make such return shall, without assessment or notice and demand from the Secretary, pay such tax to the internal revenue officer with whom the return is filed, and shall pay such tax at the time and place fixed for filing the return (determined without regard to any extension of time for filing the return).

I.R.C. Sec. 6155. PAYMENT ON NOTICE AND DEMAND.

(a) *General rule.*—Upon receipt of notice and demand from the Secretary or his delegate, there shall be paid at the place and time stated in such notice the amount of any tax (including any interest, additional amounts, additions to tax, and assessable penalties) stated in such notice and demand.

* * *

I.R.C. Sec. 6601 (as amended). INTEREST ON UNDERPAYMENT, NONPAYMENT, OR EXTENSIONS OF TIME FOR PAYMENT, OF TAX.

(a) *General Rule.*—If any amount of tax imposed by this title (whether required to be shown on a return, or to be paid by stamp or by some other method) is not paid on or before the

last date prescribed for payment, interest on such amount at an annual rate established under Section 6621 shall be paid for the period from such last date to the date paid.

* * *

(b) *Last Date Prescribed for Payment.*—For purposes of this section, the last date prescribed for payment of the tax shall be determined under chapter 62 with the application for the following rules:

* * *

(4) *Last Date For Payment Not Otherwise Prescribed.*—In the case of taxes payable by stamp and in all other cases in which the last date for payment is not otherwise prescribed, the last date for payment shall be deemed to be the date the liability for tax arises (and in no event shall be later than the date notice and demand for the tax is made by the Secretary).

* * *

(e) *Applicable Rules.*—Except as otherwise provided in this title—

* * *

(3) *Interest on Penalties, Additional Amounts, or Additions to the Tax.*—Interest shall be imposed under subsection (a) in respect of any assessable penalty, additional amount, or addition to the tax only if such assessable penalty, additional amount, or addition to the tax is not paid within 10 days from the date of notice and demand therefor, and in such case interest shall be imposed only for the period from the date of the notice and demand to the date of payment.

* * *

STATEMENT OF THE CASE

Morton-Norwich Products, Inc. and its predecessor corporations ("Morton-Norwich") made loans and advances to certain foreign subsidiaries over a period of years. Morton-Norwich charged its subsidiaries no interest on these loans and advances. The Government, pursuant to Section 482 of the Internal Revenue Code of 1954, as amended (the "Code"), imputed interest income to Morton-Norwich commencing with its tax year ending December 31, 1965, through the year ending June 30, 1973, inclusive. Morton-Norwich refused to consent to the Commissioner's action, and filed petitions with the United States Tax Court challenging said deficiencies with respect to certain of the tax years and periods involved. Morton-Norwich and the Government commenced settlement negotiations with respect to the Section 482 issue for all the above years.

Prior to final settlement of the case, the United Court of Claims, in *Motor Fuel Carriers, Inc.* v. *United States,* 420 F.2d 702 (Ct. Cl. 1970), decided, in context of the accumulated earnings tax (Sections 531 through 537 of the Code), that since the exercise of discretion by the Government is the liability generating event under Section 531, no liability existed until the Government exercised that discretion. Taxpayer had no right, duty, or obligation to report the tax. Accordingly, it was held that under the relevant statutory interest provisions, interest on the deficiency attributable to the discretionary action of the Government under Section 531 could commence only upon receipt of notice and demand for payment of the tax, the date the liability vested, and not on the due date of the return. Since the taxpayer could not report tax which did not exist on the return due date, there being no obligation for tax at that time, the statutory interest provisions premised upon deficiencies in tax which should have been shown on the return were held not to apply. Subsequent to *Motor Fuel Carriers,* numerous additional decisions unanimously adopted the Court of Claims

holding in the accumulated earnings tax context including decisions by the Sixth and Ninth Circuit Courts of Appeal.[1]

Since tax attributable to a Section 482 allocation is dependent upon discretionary action by the Government just as is tax attributable to accumulated earnings, and since a taxpayer is precluded from reporting tax under Section 482 to the same extent that a taxpayer is precluded from reporting accumulated earnings tax, and based upon the compellingly consistent line of Federal case authority in the latter context, Morton-Norwich and the Government settled the Section 482 issue in a manner which preserved Morton-Norwich's rights to file refund claims with respect to the settlement deficiency interest paid, which interest totalled $792,164. Morton-Norwich filed refund claims, which were denied by the Government, and Morton-Norwich instituted suit for refund in the United States Court of Claims pursuant to 28 U.S.C. 1491. Other issues which are not relevant here were and continue to be involved in the refund suit.

Morton-Norwich and the Government filed cross motions for summary judgment in the Court of Claims proceeding. A divided three-judge panel of the Court of Claims found in favor of the Government on the present issue and remanded the unrelated issues for further proceedings. Judge Bennett wrote the majority opinion, in which Judge Kunzig joined. Judge Nichols dissented in part.

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[1] *See Loper Lumber Co.* v. *United States,* 444 F. 2d 301 (6th Cir. 1971); *rev'g* unreported District Court opinion; *Bardahl Manufacturing Corp.* v. *United States,* 452 F. 2d 604 (9th Cir. 1971), *rev'g* 70-1 U.S. Tax Cas. ¶9105 (W. D. Wash. 1969). *See also Myron's Ballroom* v. *United States,* 382 F. Supp. 582(C. D. Cal. 1974), *rev'd on other grounds, sub. nom., Myron's Enterprises* v. *United States,* 548 F. 2d 331 (9th Cir. 1977). Additionally, the Court of Claims, in *Alexander Proudfoot Co.* v. *United States,* 454 F. 2d 1379 (Ct. Cl. 1972), stated that it had followed *Motor Fuel Carriers* by orders entered in some thirty-three other cases. 454 F. 2d at 1385.

The majority opinion, after characterizing Morton-Norwich's argument as presenting "an important issue of first impression" (App. 2a), decided in favor of the Government without adequately reconciling or directly addressing the important premises upon which the existing case law was based. Judge Nichols, in his separate opinion which dissented in material part from the majority opinion, stated that he had originally written his opinion "in hopes of its being accepted as a majority opinion" (App. 12a), and viewed the majority opinion as a "simplistic" one. (App. 11a). Morton-Norwich filed a motion for a rehearing *en banc,* which motion was denied.

REASONS FOR GRANTING THE WRIT

I.

We recognize that, as a statistical matter, the Court does not often exercise its supervisory powers in Federal income tax matters. The "exception should prove the rule" here. We would note the following:

1. The issue presented is not only a novel issue, but one of compelling interest to taxpayers and their representatives. Unlike the typical income tax case, which often is of relatively narrow applicability and offers minimal doctrinal "excitement", this issue is quite the reverse here. The logic of the application of the *Motor Fuel Carriers* line of authorities to other areas of the tax law and, in particular, to Section 482 tax deficiencies, is compelling.

2. The issue presented here is not only novel, but one of enormous significance to the Treasury and to effective income tax administration. While we do not have access to information describing the aggregate amount of interest paid with respect to Section 482 deficiencies, the amounts are substantial. Furthermore, the principles set forth herein could logically extend beyond Section 482 to other areas of the tax law.

3. The issue, at this point, has not been finally decided and, in fact, the state of the law is confusion. The statutory interest provisions are clearly supportive of Morton-Norwich's position. *Motor Fuel Carriers* was decided by the Court of Claims *en banc,* and has been adopted by the Sixth and Ninth Circuit Courts of Appeal. Only a divided panel of the Court of Claims is responsible for reversing the doctrine heretofore established, and the doctrinal reversal has occurred in a manner which has not addressed the principles upon which the pre-existing authorities were premised.

The combination of the novelty and general interest presented by this issue, its enormous fiscal implications, and what Petitioner submits to be the serious conflict created by the divided panel's opinion, virtually assures that the issue will arise in many contexts, and in many jurisdictions, in the near future. There is, further, little doubt of the likelihood that there will be a substantial disparity and inconsistency in future court decisions. The resulting effect upon judicial economy and administration and the implications to the Treasury will be substantial and adverse.

Accordingly, Petitioner submits that for the foregoing reasons, the issue is one with respect to which the need for this Court to exercise its supervisory powers will soon be clear. Petitioner submits the time for the Court to exercise such powers is now—before the above consequences are manifest.

II.

The Federal system of taxation relies heavily upon each taxpayer completely and accurately reporting its income tax liabilities on a timely basis. Governmental reliance upon proper reporting by taxpayers results in the system often being

referred to as "self-assessing". The taxpayer is expected to properly and timely report its income on its return, and to pay the tax shown no later than the return's due date.

The self-reporting philosophy is reflected in the Code provisions governing interest on tax underpayments. As will be demonstrated below, the liability for reportable taxes, for interest computation purposes, accrues on the date the return is due. If the taxpayer should have reported more tax, interest does not run from the time liability for the additional tax is ultimately adjudicated, but from the time that tax should have been reported and paid. If, however, the reporting of tax is neither required nor permitted, relevant Code provisions provide that interest commences, not with the filing of the return, but upon the date the liability for tax arises. As demonstrated by the *Motor Fuel Carriers* line of cases, an interest obligation premised upon the self-reporting philosophy does not extend to a situation in which tax cannot be self-reported and in which an exercise of Governmental discretion is the condition precedent to the very existence of the liability for tax at issue.

Tax liability resulting from an allocation under Section 482 cannot be reported by a taxpayer, because discretionary action by the government is the liability-generating event. Since liability for tax vests only at such time as governmental action has resulted in an enforceable tax consequence, Plaintiff maintains that interest may commence only at that time. This conclusion is supported by: the relevant Code provisions governing interest on tax (discussed in Part A)[2]; the *Motor Fuel Carriers* line of authority (discussed in Part B); and the clear application of the foregoing to the rationale of Section 482

[2] Various of the Code provisions cited in this part were modified, during the time period here involved, in respects not material to the legal issue. For clarity in discussion, the version of the Code provisions after the effective date of P. L. 93-625 (July 1, 1975) are used in the text below.

(discussed in Part C). Finally, the clearly erroneous decision of the Court of Claims below is discussed in light of the statutory and case law principles (Part D).

A.

Under Applicable Code Provisions, Interest On Tax Which Is Not Reportable On A Return Commences On The Date Of Notice And Demand For Such Tax, And Not With The Due Date Of The Return.

Section 6601(a) of the Code provides that interest must be paid on tax from the last date prescribed for payment of the tax to the date paid. Section 6601(b) provides that "the last date prescribed for payment of the tax" is to be determined under chapter 62 of the Code, with the application of various rules contained in Section 6601(b). Relevant here is Section 6601(b)(4), which states that if the last date for payment is not otherwise prescribed, the last date for payment is the date the liability for tax arises, which shall not be later than the date notice and demand for the tax is made.

Chapter 62 of the Code (Sections 6151 through 6157), entitled "Time and Place for Paying Tax", prescribes the last date for payment of tax, that date, again, being the interest commencement date under the general rule of Section 6601(a). Section 6151, entitled "Time and Place for Paying Tax Shown on Returns", reads pertinently as follows:

> (a) GENERAL RULE.—Except as otherwise provided in this subchapter, *when a return of tax is required under this title or regulations,* the person required to make such return shall, without assessment or notice and demand from the Secretary, *pay such tax* to the internal revenue officer with whom the return is filed, *and shall pay such tax at the time and place fixed for filing the return* (determined without regard to any extension of time for filing the return).

I.R.C. § 6151(a) (emphasis added).

Section 6155(a) provides that upon receipt of notice and demand from the Secretary, the amount of any tax therein stated shall be paid. No other section of Chapter 62 bears upon the issue.

The general rule set forth in Section 6601(a) is limited by the special rule of Section 6601(e)(3), which provides that interest in respect of any assessable penalty, additional amount, or addition to the tax runs only if the amount is not paid within 10 days from the date of notice and demand therefor, and the interest accrues in such case from the date of notice and demand.

The above statutory provisions are the basis for Petitioner's position. In capsule form, if a tax is viewed as a penalty, interest commences with the date of notice and demand for payment of the tax. Otherwise, interest runs from the last date prescribed for payment of the tax. That date is the date fixed for filing the return *only "when a return of tax is required."* Section 6151(a). When a return of tax is not required, the due date of the return has no significance. In such a case, the last date prescribed for payment is the date of notice and demand for payment of the tax.

B.

The Case Law Confirms That If Taxpayer Cannot Report A Tax, And If Liability For The Tax Requires Action By The Government, Interest Commences Upon Notice And Demand For Payment.

The case law construing the above-discussed Code provisions clearly establishes that interest on tax which cannot be reported should not be premised upon a reporting obligation, but should commence to run with the date of notice and demand for payment. While the case law has been predominantly in the context of determining interest on accumulated earnings taxes imposed under Section 531, as will be seen

below, the controlling principles are fully applicable to interest on tax resulting from the Government's exercise of discretion in making a Section 482 allocation.

The Court of Claims decision in *Motor Fuel Carriers, Inc.* v. *United States,* 420 F.2d 702 (Ct. Cl. 1970), is the watershed[3] case in the development of the now-established principle that interest attributable to an accumulated earnings tax assessment commences with the date of notice and demand for payment. Taxpayer in *Motor Fuel Carriers* was assessed deficiencies which included additional tax under Section 531, and interest thereon, from the due date of its return. Taxpayer paid all amounts alleged due and sued to recover the tax attributable to the accumulated earnings adjustments. After judgment was returned for the Government, taxpayer filed a refund claim for interest paid with respect to the accumulated earnings tax, and after rejection of the claim, filed suit for refund in the Court of Claims. The Court concluded that interest commenced on the date of notice and demand, basing its decision on the alternative grounds that (1) the accumulated earnings tax is an "assessable penalty, additional amount or addition to the tax" within the meaning of Section 6601(e)(3)[4], hence governed by the specific provisions thereof; and (2) assuming applicability of the general rule of Section 6601(a), the "last date prescribed for payment" was the date of notice and demand for payment.

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[3] *Motor Fuel Carriers* was preceded by Rev. Rul. 66-237, 1966-2 C. B. 508, and *Bardahl Manufacturing Corp.* v. *United States,* 70-1 U.S. Tax. Cas. ¶9105 (W. D. Wash. 1969), each of which held that interest commenced with the due date of the return. Subsequent to *Motor Fuel Carriers,* Rev. Rul. 66-237 was revoked (Rev. Rul. 72-324, 1972-1 C. B. 399), and *Bardahl* was reversed (452 F. 2d 604, 9th Cir. 1971). A consistent line of authority adopting *Motor Fuel Carriers* followed. See footnote 1.

[4] The Section was redesignated, effective July 1, 1975, as Section 6601(e)(3) by P.L. 93-625, § 7(b)(1). Other technical changes made were of no substantive import. The Section was previously Section 6601(f)(3).

While the Court decided on dual grounds, the reasoning underlying each was that since the accumulated earnings tax is not reported, but requires action by the Government to generate the liability, the date the return was due had no significance for interest computation purposes.

The first-discussed basis for decision was that Section 6601(e)(3) controlled. The Court did not find technical arguments made either by the Government or the taxpayer to be controlling. Rather than resort to a technical basis for decision, the Court stated:

> Given the breadth of the phrasing of § 6601(f)(3), we think that the proper way to interpret the provision is to seek the reason why—for the subsection, in contrast to other interest provisions—interest is allowed to run only after notice and demand, and not from an earlier time.

420 F.2d at 707.

In analyzing "why", the Court continued:

> It seems plain that the answer lies in the need, in these instances, for an administrative determination by the Service. The factor common to the chapter 68 items which § 6601(f)(3) admittedly covers . . . is that a Service determination precedes the imposition of those penalties and additions. *The taxpayer knows that he has to pay because the Service tells him so; these are not items which are treated as self-assessable or which the taxpayer is expected to remit before demand is made.* In other words, we infer that § 6601(f)(3) covers those "extra" payments or sanctions which the taxpayer can properly wait for the Service to determine and invoke, and which he need not himself include in his tax return.
>
> As we have indicated, the accumulated earnings tax falls into this class of additional payments. A taxpayer can properly file its corporate return without paying any attention to this tax; in so doing it will not make any erroneous or false statement nor will it leave its return with any

> omission or gap. . . . The reason is, of course, that an administrative decision is the normal precondition.

420 F.2d at 707. (emphasis added)

Finally the Court rejected the Government's attempted analogy between the personal holding company tax and the accumulated earnings tax:

> Finally, defendant's analogy to the tax on personal holding companies (26 U.S.C. §§ 541-547) is unpersuasive; that tax is reportable on the return, is meant to be so reported, and is treated as self-assessable.

420 F.2d at 708.

The same line of reasoning was cited in support of the Court's alternative basis for decision that under Section 6601(a), the "last date prescribed for payment" was the date of notice and demand for payment:

> Since, as we have pointed out, the accumulated earnings tax is not reportable on any return, but rather "result[s] from the initiative of the tax collector and not, as is more usual with other income taxes, from the initiative of the taxpayer" (Govt. Br. at 5), it follows that this tax becomes payable only upon notice and demand by the Internal Revenue Service. For that reason, the part of chapter 62 we deem applicable is § 6155. . . .

420 F.2d at 708.

On such alternate basis, interest was held to have commenced on the date of notice and demand.[5]

The initiative shown by the Court of Claims was followed by the other courts faced with the issue[6] and, ultimately, was even accepted by the Internal Revenue Service.[7] Since *Loper*

[5] The taxpayer and the Government assumed that § 6601(c)(4) ("Last date for payment not otherwise prescribed") would apply if plaintiff prevailed. The result, however, would have been the same. See, *Loper Lumber Co.* v. *United States,* 444 F. 2d 301 (6th Cir. 1971).

[6] See, for example, footnote 1, *supra.*

[7] See footnote 2, *supra.*

Lumber Co. v. *United States,* 444 F.2d 301 (6th Cir. 1971), is the only case further elaborating upon the *Motor Fuel Carriers* rationale, only that opinion is discussed here.

After setting forth the facts, and the Government's reliance on Section 6601(a) as controlling, the Sixth Circuit in *Loper* viewed the determinative issue to be the definition of the "last date prescribed for payment". In addressing the issue the court again stressed the inability to self-report an accumulated earnings tax liability, quoting extensively from the Court of Claims in *Motor Fuel Carriers.* 444 F.2d at 303. In rejecting application of the "general rule" that the due date of the return was the last date prescribed for payment in the case of a *non-reportable* tax, the court followed the *Motor Fuel Carriers* line of analysis in stating:

> We do not consider this general rule to be applicable in the present case since no return of tax is required on the part of the taxpayer in connection with the accumulated earnings tax. *We read the general rule of § 6151 (a) as designed to cover only the ordinary tax situation in which the taxpayers are required to file a return showing the tax calculated as due and owing, and not the situation here involved in which the Commissioner, not the taxpayer, calculates the tax.* This distinction is highlighted by the title of § 6151: "Time and place for paying *tax shown on returns.*" (emphasis added) While taxpayers would not be entitled to a refund of interest if they had merely "undercalculated" a tax that was self-assessing and shown the undercalculated amount on their returns, *United States* v. *Northwestern Mutual Ins. Co.,* 315 F.2d 723 (9th Cir.), § 6151(a) at the most is limited to taxes which are shown or "showable" on a return. The Commissioner does not provide a method by which taxpayers can calculate the accumulated earnings tax nor does he provide a form or "return" on which to report the tax. We therefore conclude that § 6151 is not applicable here.

444 F.2d at 304. (emphasis added)

Having fully adopted the *Motor Fuel Carriers* rationale to limit Section 6151 to tax that may be reported, the court held

the date of notice and demand to be the controlling date under Section 6601(c)(4).

Only one case has involved an attempt to apply the *Motor Fuel Carriers* rationale to a situation other than an accumulated earnings tax deficiency. In *Hart Metal Products Corp.* v. *United States,* 76-2 U.S. Tax Cas. ¶ 9781 (Ct. Cl. 1976), taxpayer asserted that interest on a personal holding company tax deficiency was within the rationale of *Motor Fuel Carriers.* The Court of Claims properly rejected the argument, emphasizing the self-reporting basis of its *Motor Fuel Carriers* opinion, and stating:

> We held, however, in *Motor Fuel Carriers* (citation omitted) that § 6601(f)(3) applies only to such additions which need an administrative determination by the Service before the taxpayer can know that he is liable for them. We also indicated explicitly that the personal holding company tax (unlike the accumulated earnings tax) falls outside that category; "that tax (i.e., the personal holding company tax) is reported on the return, is meant to be so reported, and is treated as self-assessable." (citation omitted). A taxpayer is clearly required to report (on its return) personal holding company income and to pay the personal holding company tax with its return.

76-2 U.S. Tax Cas. at 85,537.

The foregoing authorities demonstrate with consistency that if a tax must await a determination by the Government, and is unreportable by taxpayer, the due date of taxpayer's return has no significance in computing interest. Simply stated, on the basis of common sense alone, an obligation to pay interest premised upon failure to properly report a tax does not logically extend to tax which cannot be reported.

The analysis underlying the reasoning of the courts as outlined above is fully applicable to any non-reportable tax, the liability for which arises *as a result* of governmental action. As is demonstrated in the following discussion, tax resulting from a Section 482 allocation is such tax.

C.

Since A Tax Imposed As A Result Of A Section 482 Allocation Cannot Be Reported By A Taxpayer, But Requires A Prior Exercise Of Governmental Discretion, Interest Commences Only After Liability For The Tax Arises, And Not Upon The Filing Of The Return.

There is no liability for tax resulting from a Section 482 allocation until the government, through discretionary action, determines that a liability exists, and the liability results in an enforcible tax consequence. The above conclusion is manifested in the language of Section 482, its legislative history, the Government's own regulations, and the case law, and there is no room for a contrary interpretation. As such, the statutory framework discussed in Part A and the case law as discussed in Part B are fully applicable to tax resulting from a discretionary Section 482 adjustment.

Section 482 reads, in full text, as follows:

> In the case of two or more organizations, trades, or businesses (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) owned or controlled directly or indirectly by the same interests, *the Secretary may* distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among such organizations, trades, or businesses, if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such organizations, trades, or businesses.

I.R.C. § 482. (emphasis added)

As demonstrated by the emphasized language, the making of a Section 482 adjustment is completely discretionary with the Secretary. Implicit in that language is the fact that even "if [the Secretary] determines that" an adjustment under Section 482 is required, "the Secretary *may,*" but need not, make such adjust-

ment. There is no obligation placed upon the Secretary to make an adjustment. Nor is there any power given to the taxpayer to take, or to require the Secretary to take, any such action. If the Secretary does not make a Section 482 allocation, whatever the reason, there is no liability for the tax.

The legislative history of Section 482 demonstrates that the above pattern is purposeful. Section 482 originated as Section 240(d) of the Revenue Act of 1921, which was an adjunct of the consolidated return provisions, and gave the Commissioner the power to consolidate the accounts of related trades or business in certain instances. Section 240(d) was amended, as part of the Revenue Act of 1924, to provide that "the Commissioner may *and at the request of the taxpayer shall*" consolidate accounts in such cases. As a result of the 1924 Act, the taxpayer had the power to invoke the statutory predecessor of Section 482. Section 240(d) was re-enacted as Section 240(f) of the Revenue Act of 1926. 44 Stat. 46.

Section 240(f) became Section 45 of the Revenue Act of 1928, with various significant changes. First, the statute spoke in terms of the power to "distribute, apportion, or allocate gross income or deductions," rather than to consolidate accounts. Most importantly, however, that power was made totally discretionary in the Commissioner—the taxpayer's right under the 1924 Act to cause the statute to be invoked was eliminated. Section 45 remained in the above form, with only minor changes, until its re-enactment as Section 482 of the Internal Revenue Code of 1954. The text of Section 482 has since only been technically revised.

Thus, as is evidenced not only by the present language of Section 482, but by the development of that language, a taxpayer has no right or obligation to make, or cause to be made, adjustments under Section 482. A taxpayer's only obligation is to report its gross income and deductions in a manner which accurately reflects its business transactions as

they exist. The sole right to make a section 482 adjustment which would conform, for tax purposes, the actual facts and circumstances to what the Government feels might have been the form had the parties not been related, belongs to the Government, and that right is one to be exercised in its discretion. As provided in the Regulations promulgated under Section 482:

> Section 482 grants no right to a controlled taxpayer to apply its provisions at will, nor does it grant any right to compel the district director to apply such provisions.

Treas. Reg. § 1.482-1(b)(3) (1968).

Interstate Fire Insurance Co. v. *United States,* 215 F. Supp. 586 (E.D. Tenn. 1963), *aff'd,* 339 F.2d 603 (6th Cir. 1964), demonstrates how the above principles are applied. In that case, taxpayer was advised, on audit, that a reallocation of expenses on a cost basis pursuant to Section 482 would be made. As a result, taxpayer developed a cost accounting system, in consultation with the IRS agent, as a basis for reallocation. The cost accounting method formulated was found to be sound and correct. Having devised the system, taxpayer filed amended returns. The primary theory of taxpayer was that since the agent invoked his discretion under Section 482, taxpayer was entitled to use of the method. For pertinent purposes, the issue was whether or not Section 482 had been invoked. In assessing the question, the court stated:

> Section 482 provides that the Secretary of the Treasury or his delegate "may" reallocate the expenses, etc., of a controlled taxpayer "if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect income." The above quoted language makes two things apparent. In the first place, use of Section 482 is discretionary with the Secretary or his delegate. Both the legislative history and the treasury regulations issued confirm this. In the second place, use of Section 482 requires a

> determination by the Secretary or his delegate that a reallocation is necessary to avoid tax evasion or to clearly reflect the income. *National Securities Corp.* v. *Commissioner,* 3 Cir., 137 F. 2d 600.
>
> In view of the discretion invested in the Secretary or his delegate it is likewise apparent that Section 482 can only be invoked by the government and its use is not a matter of right with the taxpayer. To contend otherwise would be to extend rights and privileges under Section 482 to a controlled taxpayer not enjoyed by other taxpayers, an obviously untenable result.

215 F. Supp. at 597, 598.

The Court then concluded that "as a general rule the use and application of Section 482 does not result in an enforceable tax consequence until there has been a reallocation resulting in a reassessment of taxes." 215 F. Supp. at 598. The Court further stated that cases of abuse of discretion or estoppel were not subject to the general rule, and, accordingly, held that since taxpayer went to substantial expense in formulating the system with respect to its 1955 tax year, the cost accounting method would be applied for that year only.

Thus, a tax liability can arise pursuant to a Section 482 adjustment only if, and when, governmental discretion has been exercised and has resulted in an assessment of the tax, and, as in the accumulated earnings context, interest can commence only at that time. The integral language of *Motor Fuel Carriers* quoted and of *Loper Lumber* quoted in Part B *supra* is of equal applicability to a Section 482 tax liability.

Thus, under Section 482, the taxpayer has no duty or right to report. There is no liability, whatever the underlying facts and circumstances, absent the exercise of governmental discretion, and the culmination of that action in an enforceable tax consequence. The myriad of factors which may influence the exercise—or non-exercise—of discretion in any particular case, while not discussed above, only compounds the difficulties. The

foregoing are not merely common sense observations, but, as demonstrated above, clear legal conclusions mandated by the statutory pattern, the Government's own regulations, and the case law.

D.

The Decision Below Fails To Address Well Established Doctrine

Outlined above is a very basic proposition which is evident, not only by virtue of the statutory interest provisions, but the case law, that a taxpayer cannot, and should not, be expected to pay interest on tax from the tax return due date if the taxpayer was legally prohibited from reporting that tax on the return. The Court of Claims failed to address this basic principle, and, as such, that opinion is seriously deficient.

In lieu of focusing upon the issue, the majority Court of Claims opinion, at considerable length, states that the purpose of Section 482 is to correct income, while Section 531 can be described as a penalty. Under the *Motor Fuel Carriers* rationale, the significance of this distinction is not apparent, as Judge Nichols noted in his dissent below. The majority opinion further finds significant the fact that a Section 482 allocation is reflected in the tax imposed under Section 11. Since tax attributable to a Section 482 allocation is not reportable on a return, however, we fail to see the significance of this fact for interest computation purposes, nor, again, did Judge Nichols. In fact, the statutory interest provisions read quite to the contrary. Thus, Section 6601(a) provides that:

> If *any amount of tax* imposed by this title . . . is not paid on or before *the last date prescribed for payment,* interest on such amount . . . shall be paid for the period from such last date to the date paid.

I.R.C. §6601(a) (emphasis added). Whether discussing Section 531 or Section 11, the issue is whether "any amount" is not paid on or before the "last date prescribed for payment," in which case interest runs on "*such* amount." In determining the last date prescribed for payment, Section 6151(a), entitled "Time And Place For Paying Tax Shown On Returns," reads pertinently as follows:

> [*W*]*hen a return of tax is required* under this title or regulations, the person required to make such return shall, without assessment or notice and demand from the Secretary, *pay such tax* to the internal revenue officer with whom the return is filed, *and shall pay such tax at the time and place fixed for filing the return.*

I.R.C. §6151(a). (emphasis added) Since a return of tax resulting from a Section 482 allocation is not permitted, "*such tax*" cannot be paid at the time and place fixed for filing the return. It follows that the return due date is *not* the last date prescribed for payment. We would add that if Petitioner's plain reading of the above statute is not accepted, the continued validity of *Motor Fuel Carriers* would be in question, since the Court of Claims has itself at least suggested that the annual income tax return is a return to which the accumulated earnings tax relates, even though that tax cannot be shown thereon. *See J.O. Johnson, Inc.* v. *United States,* 73-1 U.S. Tax Cas. ¶ 9352 (Ct. Cl 1973).

The need for the exercise of the supervisory power of this Court is manifested by the thoughtful dissenting opinion of Judge Nichols below. Judge Nichols did not view either of the grounds cited by the majority opinion and discussed above as dispositive. Rather, Judge Nichols viewed the pragmatic need for administrative determination in order to determine the liability as critical. Hence, Judge Nichols would have differentiated among the years, finding in favor of taxpayer for the years prior to the 1968 adoption of the Section 482 regulations and for the Government for the later years, the theory being that after adoption, more specific guidance was available. The

views of Judge Nichols are further evidence of the fact that this important issue was not fully addressed below, and is deserving of this Court's attention.

We agree with Judge Nichols that the Court in *Motor Fuel Carriers* may well have been heavily influenced by the practical difficulties faced by a taxpayer who has no right or obligation to report tax. However, it is the lack of a right to report, rather than the difficulty in projecting liability, which was dispositive under *Motor Fuel Carriers.* While, admittedly, a taxpayer's ability to project the discretionary action which might be taken on an interest-free loan was heightened by the Regulations, a taxpayer still could not project that liability with certainty. See Treas. Reg. § 1.482-2(a)(1). Furthermore, the Regulations governing other Section 482 adjustments give taxpayers little certainty. See, for example, Treas. Reg. § 1.482-2(e). From the opposite perspective, in certain situations, a taxpayer *can* project its accumulated earnings tax liability with a high degree of certainty (if, of course, it is to be assumed that the Government will exercise its discretion and charge an accumulated earnings tax liability), but the *Motor Fuel Carriers* opinion is not limited to the difficult situation.[8] We would submit, accordingly, that the Court of Claims in *Motor Fuel Carriers* recognized, as a general rule, the practical difficulties imposed upon a taxpayer in projecting liabilities which would not exist unless the government exercised its discretion to make them exist. That recognition no doubt lead to its decision that if a liability will arise only if the Government decides to make it arise, interest runs from the date of notice and demand for payment of the tax, and not from the return due date.

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[8] One such example is the case of a mere holding or investment company. Such fact would be prima facie evidence of purpose to avoid federal income tax with respect to shareholders, and the amount of the liability would be a mere matter of computation. Section 533 (b); 535 (c) (3).

CONCLUSION

The Court of Claims, in an *en banc* decision in 1970, took an innovative and thoughtful approach to a very difficult and important issue in *Motor Fuel Carriers.* That action, despite authority to the contrary then existing, was uniformly followed in subsequent case law. The issue presented here, one of first impression and of major significance, squarely addresses the true rationale of *Motor Fuel Carriers* in an important context, and the issue will no doubt arise again, in this context and in others. The implications, furthermore, are serious. The uncertainty and conflict with respect to this difficult and important issue should be resolved now, and, accordingly, we respectfully request that a writ of certiorari issue.

Respectfully submitted,

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December, 1979

APPENDIX

APPENDIX A

In the United States Court of Claims

No. 83-77

(Decided July 18, 1979)

MORTON-NORWICH PRODUCTS, INC., A CORPORATION v. THE UNITED STATES

Frank A. Wollaeger, attorney of record, for plaintiff. *Morgan J. Ordman, Frank R. Krok, McBride, Baker, Wienke & Schlosser*, of counsel.

D. Patrick Mullarkey, with whom was *Assistant Attorney General M. Carr Ferguson*, for defendant. *Theodore D. Peyser*, of counsel.

Before NICHOLS, KUNZIG, and BENNETT, *Judges*.

ON PLAINTIFF'S MOTION FOR SUMMARY JUDGMENT AND DEFENDANT'S CROSS-MOTION FOR SUMMARY JUDGMENT

BENNETT, *Judge*, delivered the opinion of the court:

Plaintiff, Morton-Norwich Products, Inc., seeks refunds for overpayments of federal income taxes and interest for tax years 1965 through 1973. The case, which presents various claims for refund, is before the court on cross-motions for summary judgment.

In Counts II and VI of the petition, taxpayer claims refunds for a loss deductible under I.R.C. § 165(a). This loss involved research and development expenditures (R&D) incurred in an attempt to discover uses and methods of

recovery of geothermal deposits (plaintiff having had a substantial leasehold interest in a geothermal deposit), which R&D costs plaintiff had elected to capitalize pursuant to I.R.C. § 174, and claimed to have been abandoned in 1970 (Count II) or, in the alternative, 1973 (Count VI). Counts IV (for the tax year ending June 30, 1971) and V (for the years ending June 30, 1972, and June 30, 1973) examine whether, if plaintiff prevails on Count II, it may, under section 162(a), deduct certain expenses subsequently incurred as ordinary and necessary business expenses related to the underlying leasehold plaintiff retained. Per stipulation, the parties agreed that the bad debt claim stated in Count III was erroneous and properly disallowed. The amount of such losses ($38,108) is added, by stipulation, to plaintiff's deferred R&D costs, and thus to plaintiff's claim for an abandonment loss under Count II or VI.

We determine that the issues involved in these counts cannot be decided on summary judgment as, despite the existence of stipulations and agreements as to some of the facts, there are still issues of fact to be resolved. Therefore, we remand that portion of the petition to the trial division.

The issue posed for resolution in Count I of the petition is whether interest on a deficit in income tax for the taxable years at issue resulting from the allocation, pursuant to I.R.C. § 482,[1] of gross income and deductions between plaintiff and its affiliated corporation on account of non-arm's-length, interest-free loans is properly calculated from the time the original income tax returns for those years were due, or from the time that notice and demand for payment were made. This presents an important issue of first impression which is appropriate for summary judgment. For the following reasons, we hold that interest on

[1] I.R.C. § 482 provides:

"In any case of two or more organizations, trades, or businesses (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) owned or controlled directly or indirectly by the same interests, the Secretary may distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among such organizations, trades, or businesses, if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such organizations, trades, or businesses."

income tax resulting from a section 482 allocation is properly assessable from the time the original return was due and grant judgment accordingly for defendant.

Morton-Norwich is the parent of an affiliated group of corporations. During the years 1965 through 1973 it made loans to its wholly owned foreign subsidiaries. No interest was charged on these loans. During those periods taxpayer had borrowed funds from third parties and claimed deductions for interest paid on those funds. The Commissioner determined that taxpayer had underpaid its tax for those years to the extent it had not reported interest at the rate of 5 percent on the loans it tendered.[2] Correlative adjustments were made with respect to the taxes of the subsidiaries which had received the loans.[3]

The taxpayer originally filed a petition in the Tax Court challenging the IRS's determination of liability for some of the years involved. A settlement was reached and embodied in a stipulation in the Tax Court. Also, the taxpayer and Commissioner agreed upon the amount of adjustment for the years after the Tax Court action. Neither the agreement nor the stipulation waived taxpayer's right to file claims for refund or credit based on the contention that some or all of the interest on the deficiencies was not properly due the IRS. Taxpayer paid the assessments agreed upon, plus interest from the date that the tax returns for the involved periods were due to the date of payment. Plaintiff seeks a refund of the amount of interest charged from the date that the original tax was due to the date of the Service's notice and demand for payment of the deficiency.

I

The general rule for interest is that it runs from the "last date prescribed for payment," to the date paid. I.R.C.

[2] In 1968, the Secretary of the Treasury promulgated regulations specifying that, retroactive to tax years beginning after 1953, interest would be imputed on loans at the rate of 5 percent simple interest if no interest had been charged. *See* Treas. Reg. § 1.482-2(a)(2)(ii) (1968).

[3] Treas. Reg. § 1.482-1(d)(2) (1968) provides that where income or deductions are allocated to one member of a controlled group, correlative adjustments are made to the income or deductions of the other affected member.

§ 6601(a). When a return of tax is required, section 6151, entitled "Time and place for paying tax shown on returns," requires a taxpayer to pay the tax at the time and place fixed for filing the return. If the date for payment is not prescribed, the last date for payment is deemed to be the date the liability arises, in no event later than notice and demand therefor. I.R.C. § 6601(b)(4). One exception to the general rule is that interest only runs on an assessable penalty, additional amount, or addition to the tax from the date of notice and demand. I.R.C. § 6601(e)(3).

Our problem is how to treat within this framework the underpayment of income tax for a taxable year resulting from a section 482 allocation. Plaintiff's argument that the general rule does not apply depends upon the application to this case of the doctrine enunciated with respect to the accumulated earnings tax, I.R.C. § 531,[4] set forth in the opinion of this court in *Motor Fuel Carriers, Inc.* v. *United States*, 190 Ct. Cl. 385, 420 F.2d 702 (1970).

In *Motor Fuel Carriers*, this court held that interest did not begin to run on the assessment of the accumulated earnings tax until notice and demand were made. The court supported its conclusion on alternative grounds: (1) the accumulated earnings tax was an "assessable penalty, additional amount, or addition to the tax" within the meaning of section 6601(f)(3) [now I.R.C. § 6601(e)(3)];[5] and (2) if the general rule of section 6601(a) did apply, the last date prescribed for payment was the date of notice and demand pursuant to section 6155. Other courts have reached the same results with respect to the accumulated earnings tax. *Bardahl Mfg. Corp.* v. *United States*, 452 F.2d 604 (9th Cir. 1971) (section 531 tax an addition to the tax or

[4] I.R.C. § 531 provides:

"In addition to other taxes imposed by this chapter, there is hereby imposed for each taxable year on the accumulated taxable income (as defined in section 535) of every corporation described in section 532, an accumulated earnings tax equal to the sum of—

"(1) 27½ percent of the accumulated taxable income not in excess of $100,000, plus

"(2) 38½ percent of the accumulated taxable income in excess of $100,000."

[5] Subsections (c) and (f) of section 6601, applicable to the tax years in dispute, were redesignated as subsections (b) and (e), respectively, by section 7(b)(1) of the Act of January 3, 1975, Pub. L. No. 93-625, 88 Stat. 2108. For convenience, we will use the current designations of this section.

penalty (§ 6601(e)(3))); *Ray E. Loper Lumber Co.* v. *United States*, 444 F.2d 301 (6th Cir. 1971) (last date for payment of accumulated earnings tax not prescribed (§ 6601(b)(4))).

The court in *Motor Fuel Carriers* relied on the following principal factors in determining that either the accumulated earnings tax was an addition to the tax under section 6601(e)(3) or that the last date prescribed for payment was the date of notice and demand under sections 6155 and 6601(a). The first was that it was clear from the statute, the legislative history, and administrative practice that the accumulated earnings tax was separate from, and in addition to, the normal corporate income tax under section 11. The statute explicitly provides that such tax is "[i]n addition to other taxes imposed by this chapter." I.R.C. § 531. Second, the tax was not self-assessable like normal income taxes, but assessment requires "an administrative determination by the Service" of the fact and amount of the unreasonable accumulation of earnings and profits. *Motor Fuel Carriers, Inc.* v. *United States*, *supra*, 190 Ct. Cl. at 393, 420 F.2d at 707. "There is no provision in, or part of, Treasury Form 1120 (the return form) for reporting the amount subject to this tax; nor are there any schedules or instructions for reporting the item. It is left wholly to the Government's initiative." *Id.* at 390, 420 F.2d at 705 [cite omitted]. In the court's thinking, it was the second group of factors which demonstrated the logic of treating the liability for the accumulated earnings tax as not having vested until notice and demand. The logic has supported the result in respect to the accumulated earnings tax—whether the rationale was that it is a penalty or addition to the tax under *Motor Fuel Carriers* or *Bardahl*, or that the last date prescribed for payment was the date of notice and demand under *Motor Fuel Carriers*, or that the last date for payment was not prescribed under *Loper*.

Other than certain superficial similarities concerning assessments under sections 531 and 482, the provisions are not at all comparable. Section 531 imposes a tax after the normal corporate income tax is assessed under section 11, on the unreasonable accumulation of earnings and profits of a corporation. The tax is imposed on a corporation

"formed or availed of for the purpose of avoiding the income tax with respect to its shareholders * * *." I.R.C. § 532(a). Special rates, unrelated to corporate income tax rates, are applied not to taxable income, but to that portion of after-tax income which has been unreasonably accumulated.

Section 482, however, does not impose a tax by operation of its provision alone. The section authorizes the Secretary to "distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among [corporations]." I.R.C. § 482. Such action can change the amount of taxable income of a corporation for a taxable year resulting in the recomputation of the corporate income tax under section 11. The Secretary's action results in the amendment of the original corporate income tax return to show the proper amount of gross income, deductions, credits, or allowances. It is under the provisions of section 11, which provide for a tax on the taxable income of corporations, that an overpayment or underpayment of the proper tax is found.

Section 531 has often been described as a *penalty* imposed upon corporations for their failure to distribute dividends to their shareholders. *See Motor Fuel Carriers, Inc.* v. *United States*, *supra*, 190 Ct. Cl. at 391 n.6, 420 F.2d at 706 n.6. In keeping with the characterization of section 531 as a penalty, the burden of proof in a judicial proceeding is often on the Government. I.R.C. § 534(a). Whatever the proper characterization of the accumulated earnings tax, an allocation under section 482 is not a penalty, or addition to the tax, but, as pointed out by defendant, an income-correction device. The burden of proof is squarely on the taxpayer to show that the Service acted in an arbitrary manner. *See, e.g., Young & Rubicam, Inc.* v. *United States*, 187 Ct. Cl. 635, 410 F.2d 1233 (1969). Correction is effected by nonpenal, correlative adjustments in the respective corporation's taxable income. Treas. Reg. § 1.482–1(d)(2) (1968).[6] Also, consideration is taken of other non-arm's-length transactions between the corporations "in

[6] In the case of interest-free loans, imputation of interest income to the lender corporation results in imputation of an interest deduction to the borrower corporation.

the taxable year which, if taken into account, would result in a set off against any allocation which would otherwise be made * * *." Treas. Reg. § 1.482–1(d)(3) (1968). Indeed, the Service once had difficulty in asserting its power in the specific area of the imputation of interest on loans where the result worked as a penalty because of the absence of correlative adjustments. *See Tennessee-Arkansas Gravel Co.* v. *Commissioner*, 112 F.2d 508 (6th Cir. 1940); *Smith-Bridgman & Co.* v. *Commissioner*, 16 T.C. 287 (1951); Rev. Rul. 67–79, 1967–1 C.B. 117.[7]

Under section 482, the Secretary is only authorized to take action "in order to prevent evasion of taxes or clearly to reflect the income of any [corporation]." The Secretary's authority is geared to the determination of the true taxable income of a controlled taxpayer which is the taxable income which would have resulted to the controlled taxpayer had it in the conduct of its affairs dealt with the other member or members of the group at arm's length. As this court (and others) has often noted, the thrust of this section is to put controlled taxpayers on a parity with uncontrolled taxpayers. *See, e.g., Young & Rubicam, Inc.* v. *United States*, *supra*; *Eli Lilly & Co.* v. *United States*, 178 Ct. Cl. 666, 372 F.2d 990 (1967). Inherent in this section is the rationale that if transactions between related parties were structured on an arm's-length basis in accordance with economic reality, the proper corporate taxable income and tax would be returned and paid. The Government would have had the use of the revenue from the time the original return was due. If interest did not run from the time the original return was due, controlled taxpayers whose gross income and deductions were distorted due to the artificial, controlled transactions, would never be on a parity with uncontrolled taxpayers whose transactions would be structured on an arm's-length basis. The failure to impose interest until the taxpayer was *caught* by the Service would be a definite benefit to be gained by

[7] The Tax Court in *Smith-Bridgman & Co.* v. *Commissioner*, *supra*, 16 T.C. at 294, stated:

"That the respondent did not 'allocate' gross income of Continental to petitioner is apparent, since the record shows that he made no adjustment to the income or deductions of Continental."

distorting income in the controlled situation. In enacting section 482, Congress certainly did not intend that there be an incentive for income tax distortion or evasion.

Section 482 has its roots in section 240(d) of the Revenue Act of 1921 (section 240(f) of the 1926 Act) where the Commissioner was given the power to consolidate accounts of related trades or businesses for purposes of making the correct distribution of gains, profits, income, deductions, or capital in order to prevent the arbitrary shifting of profits. S. REP. No. 275, 67th Cong., 1st Sess. 20 (1921). The provision as it appears today was first enacted in section 45 of the Revenue Act of 1928 to fill in the gap or substitute for the consolidated return provisions.[8] Under the consolidated return provisions of the 1926 Act, and the power granted to the Commissioner to consolidate accounts under section 240(f), the resultant tax liability was reported on the original return filed in accordance with section 241. Though the mechanics of sections 240(f) and 45 were different, their objective was the same, to ensure that affiliated businesses paid the proper tax.

Though plaintiff does not dispute the fact that the nature and purpose of sections 531 and 482 are quite different, plaintiff contends that the mode of their determination and mechanics of their assessment are the same, and, therefore, the same rule should govern the imposition of interest. Like the section 531 tax, plaintiff argues, there is no place on the income tax return to report the tax due resulting from a section 482 allocation, and the tax imposed on account of a section 482 allocation results from an administrative determination rather than the initiative of the taxpayer. Plaintiff cites Treas. Reg. § 1.482-1(b)(3) (1968) which provides that section 482 is not available to a taxpayer nor may a taxpayer force the Service to exercise its discretion. *See also Interstate Fire Ins. Co.* v. *United States*, 215 F. Supp. 586 (E.D. Tenn. 1963), *aff'd*, 339 F.2d

[8] Section 45's purpose was described as follows:

"Section 45 is based upon section 240(f) of the 1926 Act, broadened considerably in order to afford adequate protection to the Government made necessary by the elimination of the consolidated return provisions of the 1926 Act." [H.R. REP. No. 2, 70th Cong., 1st Sess. 16-17 (1928); S. REP. No. 960, 70th Cong., 1st Sess. 24 (1928).]

603 (6th Cir. 1964). Thus, plaintiff argues, once it has chosen a particular way of dealing with its affiliates, the form is controlling of income tax consequences unless the Secretary exercises his discretionary power.

The inability of a taxpayer to report income on the basis of the substance of its transactions with an affiliate rather than the form of its transactions when the substance would result in tax savings is quite different from a taxpayer's ability or inability to report accumulated earnings tax. No taxpayer could ever possibly wish to avail itself of the privilege of paying accumulated earnings tax. A taxpayer might very well wish to use section 482 when through inadvertence or design it has treated an affiliate in a non-arm's-length manner which has resulted in increased tax liability. Under section 531, if the corporation properly distributes earnings and profits, *the corporation* has no liability for tax. On the other hand, if controlled entities properly structure their transactions on an arm's-length basis, the proper amount of tax is due and owing. Power is granted to the Secretary to achieve this result. The inability of a taxpayer to restructure the form of its transactions for tax purposes though the IRS may very well be permitted to do such has long been a part of our tax law and cannot be the determinative factor here. As the Supreme Court has stated:

> * * * This Court has observed repeatedly that, while a taxpayer is free to organize his affairs as he chooses, nevertheless, once having done so, he must accept the tax consequences of his choice, whether contemplated or not [cites omitted], and may not enjoy the benefit of some other route he might have chosen to follow but did not. [*Commissioner* v. *National Alfalfa Dehydrating & Milling Co.*, 417 U.S. 134, 149 (1974).]

On the other hand:

> * * * the Government may not be required to acquiesce in the taxpayer's election of that form for doing business which is most advantageous to him. The Government may look at actualities and upon determination that the form employed for doing business or carrying out the challenged tax event is unreal or a sham may *sustain* or *disregard* the effect of the fiction as best serves the purposes of the tax statute. To hold

> otherwise would permit the schemes of taxpayers to supersede gislation in the determination of the time and manner of taxation. [*Higgins* v. *Smith*, 308 U.S. 473, 477–78 (1940) (emphasis added).]

Section 482 is simply one statutory component of the Government's arsenal, like I.R.C. § 446(b) (power to change taxpayer's accounting method in order to clearly reflect income), or the judicial doctrines of assignment of income and tax benefit (which are, indeed, concepts included within section 482's ambit) to ensure that the correct amount of income and tax is reported and paid.

Further, we disagree with the view that a tax resulting from a section 482 allocation, like the accumulated earnings tax, is not a tax to be paid by return. Unlike the accumulated earnings tax, where there is no indication in the statutes, regulations, or income tax forms that a return of such tax is required, the tax resulting from a section 482 allocation is imposed by section 11 on the basis of a required return, Treas. Reg. § 1.11-1(a) (1960).[9] Treasury Form 1120 prescribed by Treas. Reg. § 1.6012-2(a)(3) (1968) has places for and requires the proper reporting of gross income, deductions, credits, and allowances. Though the Government may have no liability because of an overpayment caused by non-arm's-length dealing due to congressional design, the taxpayer does have a liability for an underpayment which liability accrues or vests when the return is due even though the taxpayer may not know the exact amount of that liability. *Cf. United States* v. *Northwestern Mutual Ins. Co.*, 315 F.2d 723 (9th Cir. 1963). From 1968 on, however, this taxpayer would have been aware of its exact liability on account of Treas. Reg. § 1.482-2(a) (1968) which sets explicit rules for interest-free loans. Therefore, we conclude that a liability resulting from a section 482 allocation is simply part of the general liability imposed by section 11 which requires a return. Thus, interest on a deficiency is computed in accordance with sections 6151(a) and 6601(a).

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[9] "The tax imposed by section 11 is payable upon the basis of returns rendered by the corporations liable thereto, except that in some cases a tax is to be paid at the source of the income." Treas. Reg. § 1.11-1(a) (1960).

CONCLUSION

We therefore determine that interest properly runs on an income tax deficiency resulting from an allocation under I.R.C. § 482 from the time the original return was due. Defendant's cross-motion for summary judgment is granted as to Count I of the petition and plaintiff's motion is denied. Count I of the petition is dismissed.

As to Counts II through VI, summary judgment is denied both parties and the case is remanded to the trial division for further proceedings.

NICHOLS, *Judge*, concurring in part and dissenting in part:

I agree with the court's result as to the claim under Count I for refund for interest paid on deficiencies for tax years 1968–73, but respectfully differ as to tax years 1965–67. I agree with the disposition of Counts II—VI and do not discuss them further. I do not join in the opinion except in that small part. The following relates only to Count I.

I view the approach of the majority as simplistic in its treating all tax years alike despite the decisive change in the applicable law enacted in 1968 by the regulations implementing the grant of authority in I.R.C. of 1954, § 482. The majority assumes *sub silentio* that before 1968 any layman would have known whether or not the Commissioner would make a § 482 reallocation, that the layman could or should have structured his affairs to anticipate what the Commissioner would subsequently hold was necessary to prevent evasion or clearly to reflect income, and that the layman was somewhat of a tax evader if his crystal ball failed him and the Commissioner made a reallocation he had not foreseen. Alternatively, the panel supposes that one in charge of a controlled group knows exactly the monetary differences between whatever intercompany transactions he engineers and what they would have been if conducted at arm's-length by independent entities.

It is obvious that in 1962 the Congress called for regulations because it perceived the situation entirely

differently, and wanted reallocations to rest on rules that taxpayers could know. The Treasury agonized six years at the appallingly difficult task of producing such regulations, then setting forth what was, according to our majority here, obvious.

With all respect, it appears to me the majority opinion in *American Standard, Inc.* v. *United States*, No. 379–76 (Ct. Cl. June 13, 1979) reflects the same dangerous delusion as to the obviousness (to the eye of superrational intuition, perhaps) of intricate accounting adjustments, so that the uneducated and uninstructed intellect can decide at a glance what adjustments are necessary, *e.g.*, to reflect taxable income. I show in more detail further on how unobvious it really was. Even a trained eye would not have seen an adjustment as an automatic or required consequence of the given facts. It was really and truly discretionary.

Assuming then that before 1968 the likelihood of an adjustment would depend to the ordinary mind on the exercise of uncontrolled discretion on unpublished grounds, by subordinate Treasury officials, the case seems to me to fall for 1965–67 well within the rule of *Motor Fuel Carriers, Inc.* v. *United States*, 190 Ct. Cl. 385, 420 F.2d 702 (1970). The heart of that case seems to be that the liability for interest back to the date the return is due would not include interest on a deficiency resulting from, not the facts set forth or required to be set forth in the return, or in later amendments thereto, but from the subsequent exercise of broad discretion by an administrative official.

What follows was first prepared in hope of its being accepted as a majority opinion and explains how I would treat 1965–67 and also how and why I would differentiate 1968 and later years.

The taxpayer is the parent of an affiliated group of corporations. During the years 1965 through 1973, it made loans to its wholly owned subsidiaries. No interest was charged on these loans. During those periods, taxpayer had borrowed funds from third parties and claimed deductions for interest paid on those funds. The Commissioner determined that taxpayer had underpaid its tax for those

years to the extent it had not reported interest at the rate of 5 percent on the loans it tendered. Correlative adjustments were made with respect to the taxes of the subsidiaries.

The taxpayer originally filed a petition in the Tax Court challenging the IRS's determination of liability for some of the years involved. A settlement was reached and embodied in a stipulation in the Tax Court. Also, the taxpayer and Commissioner agreed upon the amount of adjustment for the years after the Tax Court action. Neither the agreement nor the stipulation waived taxpayer's right to file claims for refund or credit based on the contention that some or all of the interest on the deficiencies was not properly due the IRS. Taxpayer paid the assessments agreed upon, plus interest from the date that the tax returns for the involved periods were due to the date of payment.

Taxpayer says it is entitled to a refund of the amount paid in interest from the date that the tax returns for the involved periods were due to the date that notice and demand for payment was made following the assessments. Appendix A lists the tax periods involved in this case and the alleged overpayments of interest claimed by the taxpayer.

I

The Internal Revenue Code requires that interest be paid on taxes due from "the last date prescribed for payment" of the tax until the date paid. 26 U.S.C. § 6601(a). Section 6151, entitled "Time and Place for Paying Tax Shown on Returns," orders a taxpayer who files a required return to pay the tax at the time and place fixed for filing the return. 26 U.S.C. § 6151. This statute applies when a taxpayer does not need an assessment or notice and demand from the Secretary. When notice and demand is issued, the tax is to be paid at the time stated in the notice. 26 U.S.C. § 6155(a). If the date for payment is not prescribed, that date is deemed to be the date the liability for payment arises, and in no event is later than the date of the Commissioner's notice and demand. 26 U.S.C. § 6601(b)(4). An exception to

these general rules is set forth in 26 U.S.C. § 6601(e)(3), which provides that:

> Interest shall be imposed under subsection (a) in respect of any assessable penalty, additional amount, or addition to the tax only if such assessable penalty, additional amount, or addition to the tax is not paid within 10 days from the date of notice and demand therefor, and in such case interest shall be imposed only for the period from the date of the notice and demand to the date of payment.

Plaintiff's argument relies heavily on our decision in *Motor Fuel Carriers, Inc.* v. *United States*, 190 Ct. Cl. 385, 420 F.2d 702 (1970). In that case, taxpayer was assessed deficiencies which included liabilities under 26 U.S.C. § 531 (the accumulated earnings tax). The IRS assessed interest from the due date of taxpayer's return. The government had successfully asserted liability. On the suit for refund of the interest assessed, this court ruled for taxpayer, concluding that interest began to run on the date of notice and demand. The court's decision was based on alternative grounds: (1) the accumulated earnings tax was an "assessable penalty, additional amount, or addition to the tax" within the meaning of § 6601(f)(3) [the present § 6601(e)(3)]; and (2) if the general rule of § 6601(a) applied, the last date prescribed for payment was the date of notice and demand pursuant to § 6155.

Plaintiff states that the theory on which these alternative grounds lie applies to the present case. The rationale for both alternatives in *Motor Fuel Carriers, Inc., supra*, plaintiff argues, was that there was a need for an administrative determination before taxpayer owed any accumulated earnings tax. The court stated:

> * * * It is inherent in the nature of the tax—and was formerly recognized specifically by Congress—that a taxpayer can hardly determine for itself, with any accuracy, if the tax is due, and if so to what extent. * * * [190 Ct. Cl. at 390, 420 F.2d at 705.]

The same focus on the need for an administrative determination of tax liability influenced the decision of other courts in cases following *Motor Fuel Carriers, see, e.g., Bardahl Mfg. Co.* v. *United States*, 452 F.2d 605 (9th Cir. 1971); *Loper Lumber Co.* v. *United States*, 444 F.2d 301 (6th Cir. 1971). Both cases ruled that interest was not due on the accumulated earnings tax until date of notice and demand. *Bardahl* explicitly adopted the reasoning of *Motor Fuel Carriers* in support of its conclusion that § 6601(f)(3) controlled; *Loper* did not rule on the applicability of that statute. Rather, the Sixth Circuit reached the same result as *Motor Fuel Carriers*, but did so by holding that § 6601(c)(4) [redesignated § 6601(b)(4) in 1975] controlled rather than §§ 6601(a) and 6155.

II

The present arguments and indeed the analysis in *Motor Fuel Carriers* and subsequent cases focus on whether the taxpayer could self-assess and report its tax liability as determined at the time it filed its returns. Plaintiff argues that § 482 is a discretionary tool of the IRS, that the IRS may or may not use it as it sees fit, and that at the time of filing its return Morton-Norwich could not possibly have accommodated for a possibility that the IRS would declare it liable for additional tax, nor estimate the amount of tax. Given then that affirmative IRS action was necessary for the IRS to generate income tax liability, there is no authority to assess interest back to the date the return is due. Taxpayer can argue either (a) the tax is a "penalty, additional amount, or addition to the tax" under § 6601(e)(3); (b) under § 6601(a) the last date prescribed for payment is the date of notice and demand pursuant to § 6155; or (c) as no tax is due on the date the return is filed, under § 6601(b)(4), the last date for payment is not prescribed, so tax liability does not incur until there is notice and demand for the tax. The first two arguments have their basis in *Motor Fuel Carriers*; the last in *Loper*.

The government, however, discounts the applicability of *Motor Fuel Carriers* and its progeny with two arguments, both based on the fact that those cases dealt with the accumulated earnings tax and this case concerns a deficiency assessed under §482. First, it emphasizes that § 482 is not a penalty but an income-correction device. It contrasts § 482 with the accumulated earnings tax, which

has traditionally been considered as and often been described as a "penalty." *See Note, The Accumulated Earnings Tax—Sections 531–37 of the 1954 Code*, 64 NW. UNIV. L. REV. 239, 240 (1969). The accumulated earnings tax is not directly related to the quantum of a taxpayer's income. Once a determination of accumulated taxable income as defined in § 535 is made by the IRS according to the procedures specified in §§ 532–34, a tax equal to the sum of 27½ percent of the accumulated taxable income not in excess of $100,000, plus 38½ percent of the accumulated taxable income greater than $100,000 is levied. Such a levy is an "additional amount," not a percentage of taxpayer's income, and liability arises under a different law than the ordinary income tax liability, which remains unaffected.

Defendant's second argument is related to the first, but goes beyond it. The reallocation of income under § 482 does not really change taxpayer's income tax liability for the year in which the adjustment takes place. Rather, it is designed to ensure that income taxes already due will be based on a clear reflection of the taxpayer's own income. Thus, § 482 adjusts for distortions which existed at the time the taxpayer's return was filed, that is, *when its tax on income was due*. This is what distinguishes § 482 from the accumulated earnings tax. Corporate taxpayers have an obligation to pay their true taxable income, and such true taxable income is based on arm's-length dealings with subsidiaries. This dual requirement is stated in § 11 of the Code which requires that a corporate taxpayer pay a tax based on taxable income for the tax year, and § 482 and Treas. Reg. § 1.482–1(b) [adopted in 1962], which enunciates an arm's-length standard for any reallocation of income in order to determine the correct taxable income for each taxpayer and each tax year. That § 11 tax on income is due and reportable on the date on which the return is filed.

Given this statutory scheme, defendant argues that Morton-Norwich could have anticipated a readjustment of its reported income under § 482. It was required to calculate its income as if it had dealt with its subsidiaries at arm's-length, as prescribed by the Code and regulations. Thus, when it acted in a non-arm's-length manner, it could

anticipate a § 482 reallocation. Defendant seemed to argue at one time that affiliated corporations had a legal duty to arrange their internal transactions so as not to distort the clear reflection of taxable income, and that a § 482 adjustment is made to counteract such a breach of duty. But it abandoned this extreme position, since a taxpayer could not make *sua sponte* a § 482 adjustment in its return and defendant does not have to do so.

III

Defendant is right to this extent: that a taxpayer may not reap a financial advantage by ignoring a tax statute or regulation and thus understating its income. If the § 482 reallocation was reasonably certain at the time taxpayer filed its return, as defendant argues, it is a mere technicality whether the corporate return form included a schedule specifying how the taxpayer is to make that allocation. For if an allocation is necessary to state properly the corporate taxpayer's income for a particular year, and that allocation is inevitable on audit, then the taxpayer can set aside the money at interest until the IRS audits and takes the predicted action. To allow controlled or controlling corporations to engage in non-arm's-length transactions which distort their income and then invest the owed taxes until the IRS's audit, without a requirement that interest be imposed on this deferred tax, would ignore Congress' intent that controlled companies be treated in the same manner as uncontrolled companies. *See* IRS Reg. § 1.482–1(b)(1); *cf. Manning* v. *Seely Tube & Box Co.*, 338 U.S. 561 (1950), holding that a taxpayer who has not paid a deficiency is liable for interest on it even though the deficiency itself is wiped out by a carryback.

However, until 1968, a taxpayer could not anticipate an imputed interest reallocation under § 482, as he could then and after. A taxpayer's liability for the extension of interest-free loans to controlled subsidiaries was unclear, and its tax liability could not be self-assessed under *Motor Fuel Carrier* standards. Section 482 provides that:

> In any case of two or more organizations, trades or businesses (whether or not incorporated, whether or not

> organized in the United States and whether or not affiliated) owned or controlled directly or indirectly by the same interests, the Secretary may distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among such organizations, trades, or businesses, if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such organizations, trades, or businesses.

Defendant argued that the combination of this statute with § 11 of the Code obligates a corporate taxpayer to pay tax based on his true taxable income calculated by an arm's-length standard, and that the IRS audit and reallocation was foreseeable for each year. It is true that §§ 482 and 11, and Treas. Reg. § 1.482–1(d) were in effect for the entire period at issue, but even with these guides, it was not clear what kinds of loans would distort a taxpayer's income and require a reallocation under § 482. This is true even though the IRS may have been able to assert liability successfully against some taxpayers for other types of § 482 allocations. *See e.g., Oil Base, Inc.* v. *Commissioner*, 362 F.2d 212 (9th Cir.), *cert. denied*, 385 U.S. 298 (1966). As one practitioner, commenting on the newly enacted (in 1968) regulations under § 482, stated:

> The regulations under section 482, which were proposed in 1966 and adopted in 1968, represent an attempt to establish quantitative guidelines against which the statute may be applied. *Prior to these regulations, there were practically no official pronouncements as to the government's position regarding specific types of transactions under section 482.* [Emphasis supplied.] [*R. Hoefs, Intercompany Operations: Joint Use of Employees, Services, Plant, Equipment & Intangibles*, 26 NYU INSTITUTE ON FEDERAL TAXATION 603, 606 (1970).]

Indeed, the liability for the extension of interest-free loans was very unclear. In cases determined under the predecessor of § 482, § 45 of the 1939 Code, the Tax Court and others adhered to the doctrine that § 45 only authorized reallocation of income, and that the Commissioner could not "create" income by inferring a rate of interest to be charged in order to put controlled corporations on par with uncontrolled ones. *Tennessee-Arkansas*

Gravel Co. v. *Commissioner*, 112 F.2d 508 (6th Cir. 1940), *Smith-Bridgman & Co.* v. *Commissioner*, 16 T.C. 287 (1951). It was only the adoption of regulations in 1968 that clearly demonstrated that the IRS would reject this analysis, and impute interest payments to corporations which made interest-free loans. *Hoefs, supra* at 607. Other circuit courts abandoned the doctrine of "creation of income," at least as applied to § 482 imputation of interest charges, fairly quickly after the regulations, *see e.g., B. Forman & Co.* v. *Commissioner*, 453 F.2d 1144 (2d Cir. 1971), *cert. denied*, 407 U.S. 934, *rehearing denied*, 409 U.S. 899 (1972). The Tax Court abandoned its position only recently in *Latham Park Manor, Inc.* v. *Commissioner*, 69 T.C. 199 (1977).

Until 1968, there were no specific rules to guide taxpayers like Morton-Norwich. In 1962, Congress rejected legislation to amend § 482 by specifying powers and methods of allocation. The conferees thought that the powers prescribed by § 482 were adequate, but suggested that regulatory guidelines be drawn. Rev. Act of 1962, H. CONF. REP. No. 2508, 87th Cong., 2d Sess. 18–19 (1962) *reprinted in* [1962] U.S. CODE CONG. & AD. NEWS 3732, 3738–39. The suggestion that regulatory guidelines be drawn tacitly recognizes that guidelines do not exist in the statute.

Given these inadequate guidelines for reallocation, the IRS was faced with two choices—it could continue to exercise its discretion in choosing what parties to subject to § 482 and in determining how their income would be allocated, limited by the requirement that the allocation put controlled taxpayers on par with uncontrolled taxpayers, or it could adopt regulations, thus limiting its own discretion but making its practices and policies under § 482 evident.

The IRS chose the latter course in 1968. 33 Fed. Reg. 4849 (April 16, 1968), which adopted, retroactive for the years after 1953, Treas. Reg. § 1.482–2. The IRS chose certain areas in which guidelines would be drawn, and one of these areas included the issue at bar, the making of interest-free loans to controlled subsidiaries. Under the regulations as enacted in 1968, if funds are lent from one

affiliate to another at no charge or at less than an arm's-length charge, the district director may make an allocation of income to reflect an arm's-length interest rate. Section 1.482–2(a). If the lender is not in the business of lending money, the arm's-length charge would be the amount charged by the taxpayer if it were between 4 and 6 percent. Section 1.482–2(a)(2)(i). If no interest charge had been made, a charge of 5 percent would be imputed, and income would be thus reallocated among corporate members. Section 1.482–2(a)(2)(ii). These regulations were amended in 1975, 41 Fed. Reg. 1280, but those changes do not affect the tax years at issue here. Thus, after the enactment of Treas. Reg. § 1.482–2(a), the taxpayer could foresee two occurrences—one, when it made an interest-free loan to a related company it would be liable for a deficiency, and two, that the IRS would deal with such a liability by imputing an interest rate.

Section 482 does not, of its own terms, delegate law-making power, as does § 1502 with respect to consolidated returns. The nature of the powers there granted we have recently considered in *American Standard, Inc.* v. *United States*, No. 379–76 (Ct. Cl. June 13, 1979). The respect given the § 482 regulations in such cases as *B. Forman & Co.* v. *Commissioner*, *supra*, makes them, when seen as reasonable, little short of laws. They are more than mere interpretation. They are the nuts and bolts, the girders and beams, of § 482 operations. In the absence of them, before 1968, a taxpayer could reasonably think that an imputation of interest, if foreseeable at all, was at the most a matter at the uncontrolled discretion of the revenue agent or district director. If there were internal practices or g uidelines, they were unpublished and the taxpayer had no obligation to be aware of them. Hence, as to the period before 1968, counsel's characterization of the imputation as discretionary is correct. The essence of the *Motor Fuel Carriers* precedent is that the statutory interest provisions do not contemplate that a taxpayer can or should anticipate the making of a purely discretionary determination.

Given the directives of *Motor Fuel Carriers*, once the IRS enacted regulations detailing what activities would be

considered a distortion of corporate income, the taxpayer could self-assess its liability as it was after April 16, 1968, for this type of transaction, and is liable for the interest on deficiencies accruing on tax returns filed after that date. To hold otherwise would unduly favor this taxpayer as against others who were guided by the regulation in planning intercompany transactions.

The regulation's retroactivity to tax years ending after December 31, 1953, does not alter my position that taxpayer is not liable for deficiency interest for the years up until 1968, for until 1968 taxpayer could not self-assess its potential liability, and this is the criterion by which we should determine its obligation to report income at the time of filing returns. Also, the fact that the regulation contains the permissive language "the district director *may* make appropriate allocations" (emphasis supplied) does not change the taxpayer's obligation to take notice of these guidelines at the time it filed its return; this permissive language protects the district director from being obliged to reallocate income when to do so would not produce additional revenue. The Commissioner cannot exercise this kind of discretion in a manner to discriminate between similarly situated taxpayers. *International Business Machines Corp.* v. *United States*, 170 Ct. Cl. 347, 343 F.2d 914, *cert. denied*, 382 U.S. 1028 (1965).

I, therefore, would hold that, under the analysis of *Motor Fuel Carriers*, taxpayer has made timely payment under either § 6601(a) or the present § 6601(e)(3) for the tax years 1965–1967, and may recover interest paid on deficiencies assessed for those years. I agree that taxpayer may not recover interest paid on deficiencies for the years 1968–1973.

APPENDIX A

Assessed Deficiency Against Morton-Norwich and Interest Due

Tax Year or Period Ending	Tax Attributable to Sec. 482	Interest Attributable to Sec. 482 Tax	Date(s) of Notice	Date(s) of Payment
12/31/65	$ 169,409	$ 97,385	9/09/75	9/22/75
6/30/66	128,493	70,009	9/09/75	9/22/75
6/30/67	292,769	147,959	12/01/75	12/01/75
6/30/68	343,497	136,641	5/02/75	5/19/75
4/24/69	280,383	94,713	5/02/75	5/19/75
6/30/69	44,586	17,825	1/29/76	2/17/76
6/30/70	31,234	10,613	1/29/76	2/17/76
6/30/71	351,780	98,421	1/29/76	2/17/76
6/30/72	315,506	72,321	3/17/76	3/29/76
			6/25/76	7/23/76
6/30/73	273,465	46,277	3/17/76	3/29/76
			6/25/76	7/23/76
TOTAL	$2,231,122	$792,164		

APPENDIX B

IN THE UNITED STATES COURT OF CLAIMS

No. 83-77

MORTON-NORWICH PRODUCTS, INC.

v.

THE UNITED STATES

Before NICHOLS, *Judge*, Presiding, KUNZIG and BENNETT, *Judges*.

ORDER

This case comes before the court on plaintiff's motion, filed August 3, 1979, for rehearing *en banc* pursuant to Rules 7(d) and 151(b), with reference to the decision entered herein on July 18, 1979. Upon consideration thereof, together with the response in opposition thereto, without oral argument, by the seven active Judges of the court as to the suggestion for rehearing *en banc* under Rule 7(d), which suggestion is denied, and further having been so considered by the panel listed above as to the motion for rehearing under Rule 151(b).

IT IS ORDERED that plaintiff's said motion for rehearing is denied.

BY THE COURT

/s/ PHILLIP NICHOLS, JR.

PHILLIP NICHOLS, JR.
Judge, Presiding

Supreme Court, U. S.
FILED
FEB 27 1980
MICHAEL RODAK, JR., CLERK

No. 79-980

In the Supreme Court of the United States

OCTOBER TERM, 1979

MORTON-NORWICH PRODUCTS, INC., PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

BRIEF FOR THE UNITED STATES IN OPPOSITION

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OPINION BELOW

The opinion of the Court of Claims (Pet. App. 1a-22a) is reported at 602 F. 2d 270.

JURISDICTION

The judgment of the Court of Claims was entered on July 18, 1979 (Pet. App. 1a). The Court of Claims denied a petition for rehearing en banc on September 28, 1979 (Pet. App. 1b; Pet. 1). The petition for a writ of certiorari was filed on December 21, 1979. The jurisdiction of this Court is invoked under 28 U.S.C. 1255(1).

QUESTION PRESENTED

Whether interest on a federal income tax deficiency resulting from an adjustment made under Section 482 of the Internal Revenue Code of 1954 runs from the date the return was due to be filed, or from the date of notice and demand for payment of the deficiency.

STATEMENT

Petitioner is the parent of an affiliated group of corporations. During its taxable years ended June 30, 1965 through 1973, petitioner made interest-free loans to its wholly-owned foreign subsidiaries. On audit, the Commissioner of Internal Revenue adjusted petitioner's gross income for each of these years by imputing interest on the loans it had made to its subsidiaries at the rate of five percent per annum. This adjustment, as well as correlative adjustments with respect to the wholly-owned subsidiaries, was made pursuant to the Commissioner's authority to allocate income and deductions among related entities in order clearly to reflect their income (Pet. App. 3a).

Petitioner filed a petition in the United States Tax Court seeking the redetermination of the deficiencies determined for the years 1965-1967. That proceeding was thereafter dismissed by stipulation in accordance with a settlement agreement reached by the parties as to the proper amount of adjustment for each year in issue. The parties also agreed as to the proper amount of adjustments for 1968-1973. The settlement agreements, however, did not resolve the question of petitioner's liability for interest with respect to the deficiencies for any of the years in question (Stip. in Ct. Cl., para. 4 and Ex. A). The Commissioner assessed interest on the deficiencies computed from the dates that petitioner's returns for the years involved were due to be filed. Petitioner paid these assessments of interest and brought this refund suit, contending that the interest on the deficiencies should be computed only from the date of notice and demand for payment (Pet. App. 3a). The Court of Claims upheld the Commissioner's position that the interest ran from the date the returns were due to be filed (Pet. App. 3a-11a).

ARGUMENT

The Court of Claims correctly held—in this case of first impression (see Pet. App. 2a)—that interest on an income tax deficiency resulting from an adjustment to gross income under Section 482 runs from the date the return for the year in question was due to be filed and not from the date of the notice and demand for payment.

Under Section 6601(a) of the Internal Revenue Code of 1954, interest on a deficiency runs from the last date prescribed for payment of the tax to the date of payment. Payment of the tax is due on the date the return is required to be filed. Section 6151(a) of the Code. If, on the other hand, no return is required and no other date is specified, then the last date for the payment of the tax, for purposes of computing interest, is the date the liability arises, not later, in any event, than the date of notice and demand for payment. Section 6601(b)(4) of the Code. Section 6601(e)(3) similarly provides that interest in respect of any "assessable penalty, additional amount, or addition to the tax" runs only from the date of notice and demand.

Here, petitioner made interest-free loans to its wholly-owned subsidiaries. On audit, the Commissioner determined that, if petitioner had conducted the transactions at arm's length, it would have charged interest on these loans. The Commissioner therefore made the necessary adjustments to petitioner's gross income reflecting interest from these loans in accordance with Section 482. That provision permits the Commissioner "to deny [to taxpayers] the power to shift income * * * arbitrarily among controlled corporations, and to place such corporations rather on a parity with uncontrolled concerns." *Central Cuba Sugar Co.* v. *Com-*

missioner, 198 F. 2d 214, 216 (2d Cir.), cert. denied, 344 U.S. 874 (1952). See also B. Bittker & J. Eustice, *Federal Income Taxation of Corporations*, para. 15.06, at 15-16 (1979 ed.). In applying Section 482, the Commissioner employs an arm's-length standard to reconstruct the transaction. See Treasury Regulations on Income Tax, Section 1.482-1(b)(1) (26 C.F.R.).

As this Court observed in *Manning* v. *Seeley Tube & Box Co.*, 338 U.S. 561, 566 (1950), interest is assessed against the taxpayer on underpayments on the theory that, until actual payment, he "had the use of funds which rightfully should have been in the possession of the United States." See also *United States* v. *Northwestern Mutual Ins. Co.*, 315 F. 2d 723, 725-726 (9th Cir. 1963). The adjustments made by the Commissioner pursuant to his authority under Section 482 simply put petitioner and its subsidiaries in the same position as if the transactions within the controlled group had been at arm's length. The Commissioner thereby placed these controlled taxpayers on a parity with uncontrolled taxpayers.

"As in the case of any other audit adjustment, etc.," the Section 482 adjustment is designed to reflect the proper amounts of gross income, deductions, allowances and credits on which petitioner's income tax should be computed. Since that tax was due to be paid on the date the return for each of the years in question was due to be filed, the resulting deficiency does not fall within the terms of any of the provisions of Section 6601 that would delay the accrual of interest until notice and demand for payment occur. Indeed, as the court below noted (Pet. App. 7a-8a), the adoption of any other rule with respect to interest on deficiencies resulting from a Section 482 adjustment not only would allow the taxpayer the interest-free use of funds that properly belong to the government but would undermine the purpose of Section 482 by giving controlled groups an unfair advantage over unrelated businesses. Cf. *Central Cuba Sugar Co.* v. *Commissioner*, *supra*.

2. In seeking review by this Court, petitioner acknowledges that the case presents a "novel" issue (Pet. 7), but nevertheless contends that the decision below conflicts in principle with *Motor Fuel Carriers, Inc.* v. *United States*, 420 F. 2d 702 (Ct. Cl. 1970); *Ray E. Loper Lumber Co.* v. *United States*, 444 F. 2d 301 (6th Cir. 1971); and *Bardahl Mfg. Corp.* v. *United States*, 452 F. 2d 604 (9th Cir. 1971). Those cases, however, involved the wholly different question whether interest on accumulated earnings taxes assessed under Section 531 of the Code should run from the date of notice and demand, or from the date that the return was due for the year in question. Those decisions hold that the accumulated earnings tax is an "addition to the tax" or "additional amount" with respect to which interest runs only from notice and demand under the specific provisions of Section 6601(f)(3) of the Code (now Section 6601(e)(3)). In so ruling, both the Court of Claims and the Sixth Circuit alternatively relied on the fact that the accumulated earnings tax imposed by Section 531 is payable only on notice and demand because it is not self-assessing (it is not reportable on the corporate tax return form). Hence, interest on a Section 531 assessment would begin to run only from the date of notice and demand in any event under the general rule of Section 6601(a).

Here, the Court of Claims correctly noted (Pet. App. 5a) that income tax assessments resulting from Section 482 adjustments and Section 531 accumulated earnings tax assessments are not truly comparable. The accumulated earnings tax is a separate and distinct additional tax that has been characterized as a "penalty" imposed on corporations for failing to distribute earnings accumulated beyond the reasonable needs of the business. On the other hand, a Section 482 adjustment to gross income, deductions, allowances or credits does not result in the imposition of a separate, additional tax,

but simply increases the amount of the ordinary income tax that was due and payable when the return was filed. Nor can an adjustment under Section 482 be considered a "penalty" in any sense. It merely operates to place the controlled group on a parity with uncontrolled taxpayers, thereby precluding a controlled group of taxpayers from obtaining a tax advantage through intercompany transactions at less than arm's length. The resulting deficiency thus simply represents an underpayment of the income tax that would have been due in the first instance had the parties been dealing at arm's length.

In sum, petitioner errs in contending (Pet. 17-21) that a Section 482 adjustment differs from other adjustments in income taxes because the taxpayer may not invoke Section 482 to amend its prior returns. See *Interstate Fire Ins. Co.* v. *United States*, 215 F. Supp. 586 (E.D. Tenn. 1963), aff'd, 339 F. 2d 603 (6th Cir. 1964). This circumstance does not transform the adjustment into a separate tax, imposition of which must be initiated by the government. Apart from the somewhat broader discretion granted to the Commissioner under Section 482, his authority to make such adjustments necessary to prevent evasion of taxes or clearly to reflect the income of the members of the controlled group is not substantially different from the other means available to the Commissioner to adjust income and deductions as reported by the taxpayer in order to determine proper income tax liability. See Eustice, *Tax Problems Arising from Transactions between Affiliated or Controlled Corporations*, 23 Tax L. Rev. 451, 452-463 (1968). Indeed, the principle that the taxpayer may be bound to the form in which he chose to cast his transactions (even

though the Commissioner is not) is in no way unique to Section 482. As this Court observed in *Commissioner* v. *Nat. Alfalfa Dehydrating*, 417 U.S. 134, 149 (1974)—

> while a taxpayer is free to organize his affairs as he chooses, nevertheless, once having done so, he must accept the tax consequences of his choice, whether contemplated or not, * * * and may not enjoy the benefit of some other route he might have chosen to follow but did not.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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